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Directive 86-8: Interest Expenses

Facts 1: Taxpayer Baker, a secretary, borrows \$5,000 at 10% annual interest to purchase an apartment building which procedures rental income. During the taxable year, Baker incurs interest expense in the amount of \$500 on this indebtedness which he deducts on his federal return, Form 1040 (Schedule E).

Facts 2: Taxpayer Adams, who is also a secretary, borrows \$5,000 at 10% annual interest to purchase taxable securities traded on the American Stock Exchange. During the taxable year, Adams incurs interest expense in the amount of \$500 on this indebtedness which she deducts on her federal return, Form 1040 (Schedule A).

Issue 1: May Baker deduct the \$500 of interest paid on indebtedness to purchase the rental property on his Massachusetts return?

Issue 2: May Adams deduct the \$500 of interest paid on indebtedness to purchase taxable securities on her Massachusetts return?

Discussion: Massachusetts law does not adopt the deductions permitted under section 163 of the Internal Revenue Code unless they are allowed under section 62 of the Code. G.L. c. 62, § 2(d). The deductions allowed under section 62 of the Code include the deduction for expenses attributable to the production of rents and royalties and the deduction for expenses attributable to a trade or business. I.R.C. §§ 62(1), (5), 163. Thus, a Massachusetts taxpayer may deduct interest expenses only when incurred on indebtedness attributable to the production of rents and royalties and interest expenses on indebtedness incurred in a trade or business.

Expenses incurred in managing personal investments are not expenses incurred in a trade or business. *Forte Investment Fund v. State Tax Commission*, 369 Mass. 786, 788 (1976). Thus, a Massachusetts taxpayer may not deduct interest expenses incurred on indebtedness attributable to financing personal investments.

Directive 1: Taxpayer Baker may deduct the \$500 of interest paid on the indebtedness to purchase the rental property on his Massachusetts return.

Directive 2: Taxpayer Adams may not deduct the \$500 of interest paid on the indebtedness to purchase taxable securities on her Massachusetts return.

Reference: G.L. c. 62, § 2(d); I.R.C. §§ 62(1), (5), 163; *Forte Investment Fund v. State Tax Commission*, 369 Mass. 786 (1976).

/s/Ira A. Jackson
Ira A. Jackson

Commissioner of Revenue

12 June 1986

DOR-D 86-8

This Directive represents the official position of the Department of Revenue on the application of the law to the facts as stated. The Department and its personnel will follow this Directive, and taxpayers may rely upon it, unless it is revoked or modified pursuant to 830 CMR § 62C.01(5)(e). In applying this Directive, however, the effect of subsequent legislation, regulations, court decisions, Directives, and TIRs must be considered, and Department personnel and taxpayers may rely upon this Directive only if the facts, circumstances and issues presented in other cases are substantially the same as those set forth in this Directive.